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The Draft Common Frame of Reference and "Cancellation" of Contracts

1. Introduction

In February 2008, the "Interim Outline Edition" of the Draft Common Frame of Reference (DCFR) was published under the title "Principles, Definitions and Model Rules of European Private Law".[*2] This version of the DCFR was prepared by the Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group). A final edition, covering some more areas of law and completed with explanatory comments and comparative notes, will be published by the end of 2008.[*3] The DCFR has the formal outline of a civil code, with books, chapters, sections, sub-sections, and articles. General rules on contracts are to found in Book II (Contracts and other juridical acts), covering *inter alia* rules on formation, validity and interpretation of contracts, and in Book III (Obligations and corresponding rights), dealing with *inter alia* performance and remedies for non-performance. Book IV — consisting of parts A–G — contains rules on specific contracts.[*4]

In this article, I will try to describe the interplay between the general and specific parts of the DCFR by testing the possible outcomes in cases where a party to a contract for one reason or other no longer wishes to receive performance from the other party.[*5] The discussion will concentrate on three different types of specific contracts: sales, leases and construction contracts. First, a buyer of a machine does not want to receive the machine, as he has been offered a better and cheaper machine by another supplier; second, a lessee wants to return the leased car before the end of the lease period, as he has lost his driver's license for health reasons; third, the client does not want the constructor to build the contracted warehouse on the client's land, as the business for which the warehouse was intended is no longer profitable. Typically, the buyer, the lessee and the client do this in order to reduce their total liability under the contract.

The term 'cancellation' is used in its broadest sense to cover these three situations. However, it is not employed at all in the DCFR, and it is not suggested here as an exact term.

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1 Thanks to research fellow Katherine Llorca for valuable advice, in particular on language.

2 C. von Bar et al. (eds). Principles, Definitions and Model Rules of European Private Law. München: Sellier 2008.

3 *Ibid*, pp. 3–5.

4 All references in the text regard the DCFR unless otherwise indicated.

5 As a member of the Study Group on a European Civil Code, I have profited from the discussions of the group and from unpublished drafts with comments and notes. However, all statements made here, errors included, are my own.

2. Delimitations

Several situations where a party is entitled to refuse to receive performance will **not** be dealt with in this article and they will be listed briefly.

We are not dealing with **termination for non-performance** of the seller's, lessor's or constructor's obligations. We will presuppose that timely and conforming performance is offered or would have been offered had the other party wished to receive it. On the other hand, the desire not to receive performance may well turn out to be a result of the party's inability or unwillingness to perform his own obligations.

Neither are we dealing with the situation in which a party invokes **invalidity** of a contract. A party that is not bound by the contract may reject performance by the other party, as there is no valid obligation to co-operate (concerning a contract party's obligation to co-operate, see section 3.2 below).

In some situations a party has a **right of withdrawal**. According to the DCFR, a consumer is entitled — subject to certain conditions — to withdraw from contracts negotiated away from business premises and from timeshare contracts (Book II Chapter 5).[*6] Withdrawal "terminates the contractual relationship and the obligations of both parties under the contract" (II.–5:105 (1)). This right of withdrawal may be exercised without the party having to give any reason and a buyer may well exercise his right of withdrawal just because he has stumbled across a better bargain.

A right of withdrawal or a right of "cancellation", with or without a fee, may **follow from the contract** itself, e.g. where the booking of hotel rooms for a conference may be changed within agreed deadlines according to the contract.

For some contracts, one or both parties may have a right to terminate the contract "for an extraordinary and serious reason", cf. for mandate contracts, IV.D–6:103 and 6:105. This means that a party may terminate the contract beforehand without having to pay damages, cf. IV.D–6:101 (5).[*7] This right to terminate for an extraordinary and serious reason, without liability in damages, should not be confused with the right to terminate a service contract at any time without giving reason (IV.C–2:111); in the latter cases, the other party may have a claim for damages, see section 6 below.

3. The general rules

3.1. Right to enforce performance of monetary claims

The most important rule concerning a contracting party's ability to limit liability by refusing to receive performance is found in III.–3:301, under the Section entitled "Right to enforce performance". This is a rule concerning **the other party's** right to enforce performance of payment. In the first paragraph of this Article, it is stated that the creditor is "entitled to recover money payment of which is due". Exceptions are found in paragraph (2):

> Where the creditor has not yet performed the reciprocal obligation for which payment will be due and it is clear that the debtor in the monetary obligation will be unwilling to receive performance, the creditor may nonetheless proceed with performance and may recover payment unless:
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> (a) the creditor could have made a reasonable substitute transaction without significant effort or expense; or
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> (b) performance would be unreasonable in the circumstances.

The essence of this provision is not easily grasped at first glance. It needs some reasoning based on the DCFR system of remedies. First, when a creditor is not allowed to enforce performance of an obligation, the most important remaining remedy for non-performance is typically a claim for damages (III.–3:701). Second, a claim for damages is normally limited to the extent that the creditor could have reduced his loss by taking reasonable steps (III.–3:705). Third, when the requirements in III.–3:301 (2) (a) and (b) are met, the party to whom the monetary obligation is owed is not allowed to "proceed with performance" of his own obligation. These three steps lead to the rule: when the requirements in (a) and (b) are met, the party to whom the monetary obligation is owed must accept that his claim for payment is converted into a claim for damages and that he is not entitled to damages for loss that could have been reduced by not proceeding with performance of his own obligation. For explanatory purposes, one might call it a "duty to terminate". From the perspective of the party owing the monetary obligation: by making it clear that he does not wish to receive performance, he reduces his liability under the contract by the amount that can be saved by the creditor's not proceeding with

[6] See also for explanations and notes concerning relevant EC legislation. Contract I: Pre-contractual obligations. Conclusion of contract. Unfair terms. Prepared by Research Group on the Existing EC Private Law (*Acquis* Group). München: Sellier 2007.

[7] Note the difference from the rule in BGB § 314, where a "Kündigung […] aus wichtigem Grund" does **not** exclude damages.

performance – when, that is, the requirements in (a) and (b) are met. The provision in III.–3:302 (2) deals not so much with enforcement of monetary obligations as with the creditor's right to compensation for costs that could have been saved by not proceeding with performance. This is not surprising; the right to enforce monetary claims is not in itself an issue calling for much regulation.[*8]

The content and effects of the rule just discussed are best explained with the help of some illustrations concerning different specific contracts (sections 4–6 below).

3.2. Obligation to co-operate

Some comments should also be made regarding the character of the duty to receive performance. Under the DCFR, the creditor's duty to co-operate, including the duty to receive performance, is in principle a contractual obligation and the general rules on remedies for non-performance of obligations apply. The duty to co-operate is contained in several provisions concerning specific contracts, and it is expressed in general terms in III.–1:104 (Co-operation): "The debtor and creditor are obliged to co-operate with each other when and to the extent that this can reasonably be expected for the performance of the debtor's obligation." The qualification "when and to the extent that this can reasonably be expected" can hardly be seen as a deviation from the principle of regarding the duty to co-operate as an obligation, cf. also the wording "obliged". The qualification is better read as a reminder of the fact that the obligation to co-operate is often less explicitly regulated in the contract and that the contents of this obligation must be established according to the circumstances. There are no separate rules on *mora creditoris*.

One could object that III.–1:104, with its qualification, is rather diluted compared with Principles of European Contract Law Article 1:301 (4), where 'non-performance' is defined as "any failure to perform an obligation under the contract, whether or not excused, and includes delayed performance, defective performance **and failure to co-operate** in order to give full effect to the contract" (bold added). However, there is no reason to believe that this should be seen as a change of approach.[*9]

The obligation to co-operate may in principle be enforced under the rule on enforcement of non-monetary obligations (III.–3:302), subject to the general restrictions found in that provision. However, harmonisation with III.–3:301 (2) is obviously required: to the extent that the creditor is not allowed to proceed with performance under the latter rule, it would of course be contradictory to allow enforcement of the obligation to receive performance.

3.3. Property not accepted

When a party to a contract is not willing to receive "corporeal property other than money" and the other party for this reason is left in possession with the property, the latter party must take "reasonable steps to protect and preserve it". This follows from III.–2:111 (1). The person left in possession is entitled to reimbursement of costs (III.–2:111 (4)). These rules are relevant whether or not the performing party is allowed, under III.–3:301 (2), to proceed with his performance. Even where there is subsequently a substitute transaction, protection and preservation costs may have incurred in the meantime. On the other hand, the rules concerning the discharge of the performing party's obligations on the deposit, sale or disposal of the goods according to III.–2:111 (2) and (3) are relevant only where the party has a right to proceed with performance and recover payment. This will commented upon in section 4 below.

4. The sale case

Our point of departure is the simple illustration mentioned in section 1: a buyer of a machine makes it clear, prior to delivery and payment, that he does not wish to receive performance. The reason is that he has found a better and cheaper machine elsewhere. How does this affect the contractual relationship?

[8] Comments to III.–3:302 are not yet available, but the provision corresponds closely to Principles of European Contract Law article 9:101, and the comments to the latter provision confirm the interpretation just made, see O. Lando, H. Beale (eds.). Principles of European Contract Law. Parts I and II Revised. The Hague: Kluwer Law International 2000, pp. 391–394 (notes on national law are also found there).

[9] See also the interesting comments in P. Schlechtriem, M. Schmidt-Kessel. Schuldrecht: allgemeiner Teil. Tübingen: Mohr Siebeck 2005, pp. 308–309, where the rules of BGB on *Gläubigerverzug* are characterised as *Relikt des alten Systems*, and it is stated that this institute is not known in the *Einheitsrechtprojecte*. For Norwegian law, I have argued that the doctrine of *mora creditoris* (which is not laid down in legislation) is not needed anymore, see K. Lilleholt. Norway: Contract Law and Contract Legislation. – Turku Law Journal 2002 (4) 1, pp. 1–11, 5–6.

Under the DCFR, the buyer has an obligation to take delivery of the goods (IV.A–3:101 (b)), and this obligation is fulfilled by taking steps to enable the seller to deliver and by taking over the goods (IV.A–3:301).*[10] Further, the buyer is of course obliged to pay the price (IV.A–3:101 (a)).

There is no rule in Part A of Book IV corresponding to or deviating from III.–3:301 (2). A general reference to Book III, Chapter III is made in IV.A–4:101: "If a party fails to perform an obligation under the contract, the other party may exercise the remedies provided in Book III, Chapter 3, except as otherwise provided in this Chapter." This means that the situation in our illustration is regulated by the rule in III.–3:301 (2).

Let us first suppose that the machine is ready for delivery at the time when the buyer makes it clear that he does not wish to receive performance.

The test under III.–3:301 (2) is (a) whether or not a "reasonable substitute transaction" can be made "without significant effort or expense" or (b) whether or not performance would be "unreasonable in the circumstances". It is tempting to turn the question around: when is proceeding with performance **not** unreasonable?

Let us have a look at the alternatives. We must suppose that the seller will normally be interested in getting rid of the machine (in some cases, he might prefer to keep the machine and use it for own purposes, but the reasoning is the same). Further, there is probably no requirement under the DCFR that the seller must "earn" the price by enforcing delivery. It is sufficient that delivery be tendered (albeit this is not entirely clear, cf. the wording "proceed with performance" in III.–3:301 (2)). It seems, however, that the tender must be a lasting one, unless the seller is **discharged** in one of the ways described in III.–2:111 (2) and (3), by depositing the machine, selling it or otherwise disposing of it. The seller may choose to keep the machine ready for delivery for a long time, but he is entitled only to "reasonable" costs according to III.–2:111 (4). It should be noted that the seller is not entitled to keep gains exceeding the agreed payment. If the seller insists on recovering the agreed payment, he may sell the machine or otherwise dispose of it without paying the net proceeds to the buyer. Further, he may not keep and use the machine for his own purposes without crediting the buyer with its value.

(1) If the seller does not proceed with performance, he will typically sell the machine to another customer (substitute transaction). If the transaction incurs a net profit, the buyer's liability in damages will be reduced (III.–3:705). On the other hand, it could happen that the substitute transaction results in net costs or that the seller simply has to pay somebody in order to dispose of the machine. Such costs increase the buyer's liability in damages (III.–3:702).

(2) If the seller proceeds with performance and the buyer still refuses to receive performance, the seller may deposit the machine, sell it, or otherwise dispose of it (depositing the machine normally entails costs for the seller, so sooner or later he will have to sell the machine or otherwise dispose of it in any case if the buyer does not change his mind), III.–2:111 (2) and (3). A net profit must be credited to the buyer; net costs are added to the buyer's liability in damages. Deposit costs should only be allowed for a period equal to that required to clarify the buyer's position. The economic outcome will often be the same under this alternative as under alternative (1) or, put more exactly, typically not more profitable for the seller.

(3) In principle, the seller may seek enforcement of the buyer's obligation to receive the machine. Depending on national law, this could be done by way of coercive fines against the buyer or an order allowing the seller to leave the machine at the buyer's property. Normally, the seller will be responsible for the costs of such enforcement, costs which he must rely on having covered as part of a claim against the buyer for damages. Under the present alternative, the buyer will typically have to pay more than under the two former alternatives, but it is hard to see how the **seller** will be better off.

There may be some odd cases where the buyer is the only person who can take care of the machine (there are some dangerous substances in the machine and the buyer has some monopoly in handling such waste). Then alternative (3) will be the seller's preferred option. Such cases are odd in the form of sale contracts; normally the owner has to pay to get rid of waste, and then it is a service contract.

Apart from the odd cases just mentioned, our discussion demonstrates that the economic outcome will typically be much the same under alternatives (1) and (2), while alternative (3) is typically more expensive to the buyer, without the seller being better off at all. It seems fair to conclude that proceeding with performance in the form of seeking enforcement of the buyer's obligation to receive the machine should often be regarded as "unreasonable" under III.–3:301 (2). Further, a substitute transaction – alternative (1) – will typically be "reasonable" as there is nothing to be gained by choosing alternative (2).

Does it make sense for the buyer to refuse to receive performance? If a substitute transaction will result in a net profit, the buyer could receive the machine, resell it at once, and obtain more or less the same result. Refusing to receive performance may, however, be attractive for several reasons: transportation costs can be

[10] There are some terminological discrepancies in the DCFR: "taking over the goods" in IV.A–3:301; "take control of the goods" in IV.B–5:103 (b).

saved; it may be easier for the seller to find a new customer; perhaps the buyer's liquidity does not permit him to pay the full price and then wait for the proceeds from the resale.*[11]

Now let us suppose that the machine must be produced by the seller or procured from a supplier, in both cases according to the buyer's specifications. At the time the buyer makes it clear that he will not receive performance, the machine has still not been completed or has not yet not been ordered from the supplier.

The alternatives regarding the seller's need to get rid of a half-finished machine are the same as described above and will not be commented upon.

Whether or not it is rational to complete production of the machine depends on the circumstances. Sometimes the value added by completing the production is higher than the costs; sometimes it is the other way round. At this point the seller and the buyer will typically have concurrent interests. A more important observation, however, is that it should normally be regarded as "unreasonable" to proceed with production if this only adds to the seller's loss. Often, it would be a mere waste of resources to complete a machine which is specially designed for a buyer who can no longer make use of it.*[12]

5. The lease case

In the lease case, a lessee wants to return the leased car before the end of the lease period, as he has lost his driver's license for health reasons. It should be noted that a lease for a definite period may not as a rule be terminated unilaterally beforehand by giving notice, cf. IV.B–2:102 (1). Nor is there a right to terminate the lease unilaterally for an "extraordinary and serious reason" or the like.

The lessee is of course obliged to pay rent (IV.B–5:101), and he must co-operate by taking reasonable steps in order to enable the lessor to make the goods available and by taking control of the goods (IV.B–5:103). Further, the lessee has obligations of care etc. during the lease period (IV.B–5:104–108), but the obligation to keep the goods throughout the lease period is expressed more indirectly in IV.B–6:103 (Right to enforce payment of monetary obligations).

It is stated in the first paragraph of IV.B–6:103 that the lessor is entitled to "recover payment of rent and other sums due". The second paragraph regulates the situation where the lessee makes it clear before the goods have been made available to him that he is unwilling to receive performance; the provision is a paraphrase of III.–3:301 (2). The third paragraph is an adaptation of the same rule for the situation where the goods have already been made available to the lessee:

> Where the lessee has taken control of the goods, the lessor may recover payment of any sums due under the contract. This includes future rent, unless the lessee wishes to return the goods and it would be reasonable for the lessor to accept their return.

"Cancellation" where the goods are still not made available to the lessee is the closest parallel to the sale case discussed in section 4. These cases will be left aside here. It should merely be noted that possible substitute transactions as well as halting of production or procurement of the goods specified by the lessee are also important elements of a test of reasonableness here.

In contrast to sale contracts, a lease implies a lasting performance, in that the lessor must ensure that the goods remain available for the lessee's use throughout the lease period (IV.B–3:101 (3)). Ordinarily, rent must also be paid at intervals during the lease period (IV.B–5:102). The lessee may therefore be unwilling to receive **future** performance even when the goods have already been made available. The lessee may wish to return the goods for two main reasons: the costs of keeping the goods may be saved and the liability for future rent may be reduced, either by a substitute transaction made by the lessor or by the lessor's making use of the goods for his own purposes.

Theoretically, it could be envisaged that the lessor must accept the early return of the goods without losing the right to recover rent at agreed intervals for the remaining part of the lease period. This is not, however, the solution given in IV.B–6:103 (3). If the lessor must accept return of the goods, he cannot enforce his claim for future rent but must settle for a claim in damages.

The decisive criterion in IV.B–3:101 (3) is whether or not it would be reasonable for the lessor to accept return of the goods (prior to the end of the lease period). The goods belong to the lessor and he must ordinarily be prepared to have them returned sooner or later. It is obvious, though, that the lessor may have a legitimate interest in being relieved of the responsibility of keeping the goods for the agreed lease period. This may even be the main motive for the lease contract in the first place (e.g. where somebody leases out his boat while

[11] It has been observed that such constellations typically make room for the parties to negotiate a solution, see H. Beale. Remedies for breach of contract. London: Sweet & Maxwell 1980, pp. 146–147.

[12] "Cancellation" in such cases is specifically dealt with in the Sale of Goods Acts of Finland, Iceland, Norway and Sweden (§ 52).

abroad for a period).*[13] In such cases the result may be that is **not** reasonable for the lessor to have to accept return of the goods. The possibilities of a substitute transaction must also be taken into account. If an acceptable new lessee can be found (or a buyer, depending on the circumstances), this may be sufficient to make it reasonable to accept return of the goods. In situations like these, it is therefore not unusual for the lessee to find a prospective new lessee and suggest him to the lessor.

It should be noted that a lessee has fewer choices than a buyer in a situation where the goods cannot be used for their original purpose. The buyer may receive the goods and resell or otherwise dispose of them. The lessee has, as a rule, no right to sublease the goods or assign his rights under the lease contract without the lessor's consent (and no right, of course, to sell the goods), cf. IV.B–7:102 and 7:103.

However, if consent to a sublease is withheld without good reason, the lessee may terminate the lease by giving a reasonable period of notice, cf. IV.B–7:103 (2). This is a right to terminate the contract prior to the end of the agreed lease period and such termination discharges the lessee's obligation to pay future rent.

Our case with the lessee having lost his driver's licence may then have several different outcomes:

a) The lessee may make it clear that he wishes to return the car before the end of the lease period. If it is reasonable for the lessor to accept return of the car, the lessor may not recover future rent at agreed intervals, but is entitled to damages only. The lessor must take reasonable steps to reduce his loss, typically by leasing the car to a new lessee for the remainder of the lease period.

b) The lessee may ask for the lessor's consent to sublease the car. If the lessor's consent is withheld without good reason, the lessee may terminate the lease by giving a reasonable period of notice and then be discharged of the obligation to pay future rent.

c) If it is not reasonable for the lessor to accept return of the car, and there is good reason to withhold consent to a sublease (or it is not possible to find anyone willing to sublease the car), the lessee must keep the car and pay the rent at the agreed intervals.

The outcome under c is probably practical, at least as far as car leases are concerned, particularly in situations where only a relatively short period remains of the agreed period. The lessor may have entered into a new lease starting from the expiry of the agreed lease period, and may not wish to bring in a new lessee or sublessee for a short period only; taking care of the car in the meantime may also be difficult.

6. The construction case

In our construction case, the client does not wish the constructor to build the contracted warehouse on the client's land, as the business for which the warehouse was intended is no longer profitable.

In the DCFR, construction contracts form a sub-group under service contracts and are regulated partly by general rules found in Books II and III, partly by the general rules on services (Book IV.C Chapter 2) and partly by particular rules on construction contracts (Book IV.C Chapter 3).

The client must pay the price (IV.C–2:101) and he is obliged to co-operate, in particular to provide access to the site where the construction has to take place (IV.C–3:102 (a)).

Under the service principles, the client has a general right to "terminate the contractual relationship at any time by giving notice to the service provider", cf. IV.C–2:111 (1). No damages are payable if the termination is justified, cf. IV.C–2:111 (3). Unjustified termination is dealt with in IV.C–2:111 (4):

> When the client was not justified in terminating the relationship, the termination is nevertheless effective, but the service provider may claim damages in accordance with the rules in Book III.

Possible justifications for a termination are dealt with in IV.C–2:111 (5). Suffice it to say that the client in our construction case is **not** justified in terminating the contractual relationship just because he cannot make use of the contracted building. The termination is still effective, but the constructor has a claim for damages that will put him as nearly as possible in the situation in which he would have been had the client's obligation been duly performed.

We see then that after the termination there is no longer an obligation to provide access to the site and hence no such obligation to enforce. Further, the termination puts an end to the client's obligation to make payments under the contract; this obligation is converted into an obligation to pay damages. How much the client will have to pay depends on the circumstances, *inter alia* how much of the work has already been performed when the contractual relationship is terminated. Normally, the termination will save the costs of continued investments in a building that is no longer needed.

[13] Illustration in K. Lilleholt et al. Lease of goods (PEL LG). Munich: Sellier 2008, p. 264.

7. Conclusions

We have seen that refusing to receive the other party's performance (or further performance) often makes sense for the buyer, the lessee and the client under a construction contract. The formal point of departure, found in III.–3:301, is that the creditor may proceed with performance and recover payment. The other party's obligation to co-operate may in principle be enforced and in some cases it is probably sufficient to tender performance in order to be entitled to payment. There are, however, important exceptions in III.–3:301 (2): where performance would be unreasonable, in particular where a reasonable substitute transaction is possible, the claim for payment is converted into a claim for damages.

The general rules found in III.–3:301 (2) apply fully to sale contracts. We have seen that performance will be unreasonable in many cases where "tailored" goods are to be produced or procured for the buyer and often also in cases where it is possible to obtain a substitute transaction resulting in a net profit. There may, however, be some odd cases where the seller has a legitimate interest in proceeding with performance and sometimes even enforcing the buyer's obligation to co-operate by receiving the goods.

For lease contracts, the general rules must be supplemented, both with a rule concerning situations in which the goods have already been made available for the lessee's use and the lessee wishes to return the goods (IV.B–6:103 (3)) and with a rule on termination of the lease where consent to sublease the goods is withheld without good reason. For lease contracts, too, there may be cases where it is reasonable for the lessor to proceed with performance.

The simplest rule is found in the case of service contracts, including construction contracts: the client may prevent performance (or continued performance) by terminating the contractual relationship, thus converting the claim for payment into a claim for damages. For these contracts, it has obviously not been found sufficient to adapt or to supplement the general rule, as the performance of a service that is no longer wanted should not be allowed. The termination rule should rather be seen as a deviation from the general rule.

The illustrations demonstrate that there are good reasons for supplementing the general rules on contracts with rules on specific types of contracts, this being an achievement of the DCFR as compared with the Principles of European Contract Law. It might be argued, though, that the flexibility of the general rule should make it possible to reach acceptable results for lease contracts and service contracts as well.